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REPORT

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

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COMMITTEE ON SMALL BUSINESS

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INTRODUCTION

The principle legislative jurisdiction of the Senate Small Business Committee is over programs administered by the Small Business Administration. In my view, that means something more than just allocating funds or designing programs. It means making sure that the SBA is truly serving its constituency of small business men and women across the country.

This Committee has embarked this session on a strong course of oversight over the SBA and its programs. Rather than think up new programs for the Agency to administer, we are looking closely at the old ones, making sure they are fulfilling their mandate and serving those they are designed to serve.

In five comprehensive hearings already this year, this Committee has let it be known it will demand accountability, that it will search out fraud and abuse where they exist, and that it will not rest until the Small Business Administration is giving its vital small business constituency the kind of effective, efficient representation that it deserves.

Just as important as its oversight function is the Committee's role as an advocate for the small business community.

Whether deliberating over tax policies, regulations, contracting procedures, or innovation, this Committee has tried at all times to keep in mind the millions of small business men and women across the country and act as their advocate.

Despite the fact that small businesses are responsible for 43 percent of the Gross National Product, 58 percent of private employment, and 75 percent of all new jobs in this country, small businesses have been rarely considered in the Federal policy making process.

Small businesses right now are facing a definite crisis. High interest rates, inflation, and unavailability of credit impact on us all, but nowhere is their impact greater than on the small business owner. Unless the Federal Government can begin now to address some of the real and pressing problems that every day are dragging more and more small businesses into bankruptcy, there is a real possibility that the competitive nature of our economic system will fundamentally change. The real loser, unfortunately, will be the American consumer -- who will pay more and get less.

In this 1st session of the 97th Congress, the Small Business Committee has attempted to change the climate for small business, by bringing the viewpoint of small firms into consideration when policy debates take place. The specifics of this ongoing effort are outlined in the following pages.

LOWELL WEICKER, Jr.
Chairman
Committee on Small Business

COMMITTEE STATUS

One of the first tasks the Chairman set for the Committee at the beginning of this year was to change the name and status of the Small Business Committee.

The Senate Small Business Committee was created as a "Select" committee by the 81st Congress to study and survey "by means of research and investigation all problems of American small business enterprises, and to obtain all facts possible in relation thereto which would not only be of public interest, but which would aid the Congress in enacting remedial legislation." At the time the Committee was created, it was not given any legislative authority.

However, unlike most select committees, the Select Small Business Committee was not given a termination date, and in fact, as time went on, it became more and more established as a force in the Senate. In 1976, the Senate passed Resolution 104, giving the Committee legislative authority and specific responsibility over the Small Business Administration.

That action, for all intents and purposes, gave the Committee all the powers and authority of a full, standing Committee. Further recognition of the growing importance of the committee came in 1978, when the membership, originally set at nine, nearly doubled to 17 to accommodate requests from Senators wishing to be members. Nonetheless, the "select" designation remained. While this designation was in name only, and did not limit the Committee's legislative authority in any way, Committee members felt it implied an impermanence unbefitting a Committee with such a large and vital constituency.

On March 25, 1981, the Senate unanimously approved a resolution sponsored by Majority Leader Howard Baker, Minority Leader Robert Byrd, and the entire membership of the Small Business Committee, striking the 'select' designation and awarding the Small Business Committee full, permanent status.

By adopting this Resolution, said Chairman Weicker, "the Senate has sent a clear signal to the American people that the problems of small business are not to be ignored or forgotten, but that small business and its advocate, the Senate Small Business Committee, are here to stay."

RECONCILIATION

Consistent with the effort to reduce spending in this Congress, the Small Business Committee, through the Reconciliation process, passed cost-saving legislation that reduced the Small Business Administration's program levels by over 40 percent.

The bill which emerged from the House/Senate Conference, and was adopted by the full Senate, was a carefully drafted piece of legislation designed to reallocate limited resources, establish clear priorities, and set a new direction for the Agency.

The bulk of the cuts were made in the direct and disaster lending programs, in accordance with the Committee's desire to shift the emphasis of the Agency away from making individual loans, to more productive programs. In keeping with this desire, the '503' program, which promotes economic development in urban areas, the Small Business Investment Company program, and the guaranteed lending program, were maintained at adequate funding levels.

By refocusing the activities of the SBA in this manner, the Committee believes that dollar for dollar, more jobs will be created, more expansion of healthy businesses will be undertaken, and more help will be directed where it is really needed. Ultimately, the Committee believes these structural changes will make the SBA a stronger, more effective Agency.

A summary of the major 'egisiative changes in the SBA programs follows:

On disaster lending:

- SBA was removed from farm disaster lending; the principal responsibility will rest with Farmers Home Administration.

- Homeowners, as well as business, must now comply with a credit elsewhere test when applying for disaster loans. For homeowners unable to receive credit elsewhere, the interest rate will be set at one-half the government's cost of money, plus up to 1 percent, but not to exceed 8 percent. Homeowners who can get credit elsewhere will pay at the full cost of government money, plus up to 1 percent.

  Previously, disaster loans to homeowners were given at 3 percent interest on the first $50,000 of assistance, with no credit-elsewhere test.

- Businesses able to get credit elsewhere will now pay the prevailing market rate on interest for a maximum term of three years. For businesses not eligible for credit elsewhere, disaster loans will be given at a rate not to exceed 8 percent. Businesses will be eligible for up to 85 percent of uninsured loss.

  Previously, interest rates for businesses unable to get credit elsewhere were set at 5 percent. Businesses able to get credit elsewhere borrowed at an interest rate set at the government's cost of money, plus up to 1 percent. Businesses were eligible for up to 85 percent of uninsured loss.

The following changes were made in SBA business lending programs:

- Interest rates on all direct business loans would be set at the government's cost of money, plus up to 1 percent, except in the case of loans to the handicapped individuals of organizations for the handicapped. That rate remains at 3 percent.

- A uniform maximum limit of $500,000 per borrower has been established on guaranteed loans. Maximum maturity of loans was set at 25 years, with longer periods set for loans used for construction or to acquire real estate.

- A mandatory 90 percent guarantee was imposed for guaranteed loans of $100,000 or less. Guaranteed loans of more than $100,000 up to $715,000 must be guaranteed between 70 percent and 90 percent, and guaranteed loans over $715,000 must receive a guarantee of less than 70 percent.

Authorization levels for fiscal years 1982, 1983 and 1984 were set at the following:

	1982	1983	1984
		($ in millions)	
Direct Loans	230	230	230
Guaranteed Loans	3,300	3,300	3,300
Polution Control Guarantees	250	250	250
Surety Bond Guarantees	1,400	1,400	1,400
Salaries and Expenses	227	233	239

SBA OVERSIGHT

At the start of the 97th Congress, Committee members set as one of their top priorities, continued, aggressive oversight of the Small Business Administration and its programs. As of this date, the Committee has held six days of oversight hearings, all of which pointed up problems and deficiencies in the Agency. It is the Committee's belief that SBA has a definite, needed role to play for the small business community, but that it can only fulfill that role when mismanagement and abuse are eliminated and it is operating effectively and efficiently. Already, steps have been taken to resolve some of the problems uncovered during the Committee's investigative hearings. It is the Committee's hope that as these hearings continue, the SBA will become a true advocate for the small business community.

Thus far, the Committee has looked at problems within the SBA's Farm Disaster Loan Program, the Direct Lending Program, the 8(a) Army Pilot Program, and internal Agency contracting procedures and policies.

A brief summary of the hearings and their findings follows:

THE 8(a) PILOT PROGRAM

On January 23, 1981, the Committee met to consider what appeared to be an unlawful and improper extension of the SBA 8(a) Pilot Program. The 8(a) Pilot Program was set up by Congress in 1978 as part of the SBA's ongoing minority business assistance effort. Under the terms of the two-year project, one agency -- in this case, the Army -- was designated by the President to work with SBA on this test program.

On October 21, 1980, the Congress extended the pilot for an additional year under the same terms. Shortly before the change in Administrations, however, Committee staff uncovered a memorandum issued by President Carter on December 19, 1980, unilaterally extending the pilot program to an additional three agencies, an action not permitted under P.L. 96-481.

Upon being apprised of this, the Chairman immediately called for a full Committee hearing. Due to the change in Administrations and the need for haste to resolve this matter, the hearing took place even before the Committee's organizational meeting.

As a result of the hearing, the Presidential memorandum was not implemented and the 8(a) pilot program was not expanded beyond its statutory limits.

On September 21 1981, the Committee held a hearing on S. 1620, a bill to extend the 8(a) pilot program for an additional 18 months. Testimony was received by the Committee indicating that the pilot program has not been effectively implemented with the Department of Army. However, despite this track record the new Administration sought an opportunity to use this contracting tool to develop minority businesses, and requested an extension of this authority.

Accordingly, Chairman Weicker asked that the program be extended and given a new direction. Under the extension legislation, the program would be placed with a single civilian agency, to be designated by the President. Under this plan, the Committee hopes for more complete implementation than the Army gave it.

On September 22, 1981, the full Committee ordered reported out S. 1620. It now awaits action by the full Senate.

SBA's CONTRACTING PROCEDURES

On April 27 and 28, 1981, the Committee held hearings based on a two-month staff investigation of internal procurement practices at the SBA. In testimony from the SBA Administrator, the SBA Inspector General, and current and former Agency officials, the Committee produced evidence of flagrant disregard and abuse of Federal procurement regulations by the SBA during the period of FY 1977-1980. In sum, the Committee found that:

- top agency officials pressured subordinates to circumvent Federal procurement regulations;
- contracts were awarded to friends of those same officials;
- unauthorized staff engaged in improper business negotiations with contractors;
- contracts were awarded for projects that could have been done in-house, or not done at all;
- letter contracts, a device used when a contract statement of work and costs has not been clarified, were issued indiscriminately. One such letter contract resulted in a contractor billing SBA and other agencies for personal luxury items such as a swimming pool and a tennis court;
- consultant firms have worked on projects without written contracts;
- there was blatant use of sole source contracts, despite the requirement of federal procurement regulations that contracts be awarded competitively "to the maximum practicable extent." Despite studies showing that the Government saves 25-30 percent per contract when competitive bidding is used, the Committee found that of $14.2 million in contracts, SBA awarded 92 percent on a sole-source basis.

As a result of the investigation, the Committee met in Executive Session and agreed to forward certain documents to the Justice Department for further review and possible legal action. As of this writing, that Justice Department investigation is still ongoing.

The Committee also received assurances from Administrator Michael Cardenas that such abuse within SBA would not occur again.

SBA's FARM DISASTER LOAN PROGRAM

For a three-year period, from 1977 to 1980, the Small Business Administration was heavily involved in making disaster loans to farmers. More than $3 billion went out in farm disaster loans during that time. A committee investigation of that three-year period found that hundreds of millions of dollars worth of loans were improperly awarded.

There were three main areas of abuse uncovered by the Committee in hearings on September 9 and 10, 1981:

- Overpayment. Some farmers produced better crops than they estimated when they applied for the loan, but did not return the extra loan money they received. One Georgia farmer estimated a $477,000 crop loss, but had an actual loss of only $143,000, leaving an excess payment of $334,000. A preliminary audit of 438 loans by the SBA Inspector General found a total excess payment of $6,685,948.

- Misuse of Proceeds. Instead of using the loan money for losses due to crop damage, some farmers used the money for unrelated, unallowed expenditures. One farmer made payments on a boat and a new home, while another deposited $400,000 of a $500,000 disaster loan in a Certificate of Deposit.

- Duplicate Payment. In several cases, farmers received loans from both the Small Business Administration and the Farmers Home Administration to cover the same disaster, often pledging the same collateral. A limited sample computer match between SBA and FmHA uncovered $2.3 million in duplicate loans.

In addition to findings of actual abuse, the Committee discovered a sizeable delinquency problem within the farm disaster loan program. More than half of the $3 billion in farm loans are now delinquent.

As a result of the hearings, several things occurred:

First, through legislative action during the Reconciliation process, the Committee this year agreed to language ensuring that SBA does not become so heavily involved in farm disaster lending. Much of the problem with the program occurred because SBA was offering disaster loans at interest rates substantially lower than FmHA, or on more favorable terms. As a result, many farmers who normally would have been expected to go to FmHA for a loan, flocked to SBA. The new law requires that SBA and FmHA will have "substantially the same" rates of interest on disaster loans in the future. Additionally, the Committee retained language mandating that farmers go first to FmHA for assistance before coming to SBA.

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Because only a limited audit has been performed thus far on the Farm Disaster program, it has not been possible to determine the exact extent of the abuse. As a result of the hearing, the Office of Management and Budget has authorized the formation of a 99-man task force to go into Region IV (the eight-state, southeastern region where the concentration of farm disaster loans is the greatest) and begin intensive Federal efforts to collect excess and duplicate payments.

In addition, the Department of Justice -- which previously declined to criminally prosecute several cases of alleged duplicate payment because of questionable management procedures by the SBA lending officers -- is considering taking civil action against these borrowers.

DIRECT LOAN PROGRAM

Prompted by a series of highly critical articles published in the St. Louis Globe Democrat, Senator Dixon requested hearings on the SBA direct lending program. On October 27, 1981, the Committee held what Senator Dixon called a "beginning of an examination of what needs this type of program can serve in the years ahead."

In brief, the paper's major finding were:

- of the 14,261 SBA loans from 1970-1978 in 16 cities, 42 percent have defaulted;
- 33 percent of the dollars disbursed, $157 million, was never repaid;
- SBA's collection attempts either from the loan recipients or through the courts, has been minimal. Figures show that 18 cents on each dollar is recovered;
- Loans have been concentrated in certain types of businesses (restaurants, bars) which are among the highest risk businesses to begin with;
- SBA increased the risk of loss by making loans to people unqualified to run the types of business for which they have received a loan.

As a result of the hearing, Administrator Cardenas testified that the Agency would take the following steps to shift the emphasis from "quantity" of loans to "quality."

- All numerical goals in loan making activities will be abolished.
- Performance of the loan-making staff will be measured by the quality of the loan made and the timeliness of the loan, rather than on staff's ability to "get the money out."
- A comprehensive debt collection plan will be implemented to

deal with the existing loan portfolio.

In addition, the Committee, through the reconciliation process, made changes in the Direct Lending Program that should help eliminate many of the problems highlighted by the oversight hearings.

Those changes include cutting SBA direct lending 40 percent, raising the interest rates so that they are more in line with current market rates, and consolidating credit criteria. Through these changes, the Committee hopes to reduce the artificial demand for Direct Loans that previously existed because of the availability of low-cost, easily accessible Federal money.

SMALL BUSINESS CAPITAL FORMATION

One of the major priorities of the Small Business Committee in this Congress has been to help bring about a change in our nation's tax laws in order to create tax equity for small business, and to promote capital investment, productivity and enhanced private sector job creation.

Starting in February with the introduction of S. 360, the Small Business Capital Formation Act of 1981, Chairman Weicker and cosponsors sought major improvements in the tax laws to enable small businesses to attract and retain capital. Specifically, the Committee concluded that small business was having difficulties both in attracting long term capital for new investments in plants and equipment and in retaining capital generated internally.

S. 360 addressed this dual concern by proposing (1) significant new tax credits, rollovers, and other incentives to encourage investors to make long-term equity capital available to small businesses; and (2) important new tax deductions to permit greater earnings retention. The bill would reduce corporate tax rates, accelerate and simplify depreciation deductions, reduce inventory accounting burdens, and reform estate and gift tax laws.

This bill became the point of departure for Senate consideration of small business tax legislation during the first session of the 97th Congress, as numerous other bills were subsequently introduced in the Senate or the House. Chairman Weicker and Ranking Minority Member Nunn testified on behalf of S. 360 before the Senate Finance Committee as part of this Committee's on-going collaboration with the tax-writing Committee and made some specific recommendations drawn from the bill.

As a result, when the Economic Recovery Tax Act reached the Senate floor, it contained provisions adapted directly from S. 360, including accelerated depreciation and estate and gift reform. Senators Weicker, Durenberger and Nunn offered an amendment to make a reduction in the corporate tax rate, and this amendment passed by a unanimous vote of 92-0. It is estimated that this amendment will provide $1.2 billion in tax relief for small businesses over the next 3 years.

While the new tax law does contain several provisions to encourage greater capital investment in small business, there is a substantial unfinished tax agenda for small business, particularly with respect to the attraction of long-term capital, which the Committee intends to address in the second session. In this climate of extraordinarily high interest rates, the Committee believes special measures are required to reopen the capital pipeline to small business. In the coming months, the Committee hopes that attention can be concentrated on the need to create new financing techniques for small business to permit them to participate, to a greater extent, in the reindustrialization of America.

INTEREST RATES

Just as inequitable tax policies have impinged upon the small business owner's ability to continue to do business, so too have high interest rates. Nowhere has the impact of high interest rates been more fiercely felt than with the small business entrepreneur whose day-to-day cash flow determines his failure or success.

At the request of Senator Nunn, the Committee has held five very informative days of hearings on the impact of high interest rates on smaller business. Testimony has come from labor groups, agricultural representatives, Wall Street economists, and small business men and women in the field.

The Committee will continue to study the question of high interest rates, and to search for answers to what has become the most dire problem now facing the nation's businesses.

While interest rates have begun recently to moderate slightly, there is concern that that relief will be too little, too late, or that the result will be a very deep recession. Attention has been focused on the need to reduce the Federal budget deficit, which is preempting large amounts of available credit and will continue to do so unless sharply reduced. Consideration is being given to specific proposals to brake federal spending growth and to close the accelerating revenue gap caused by the tax cut of this year.

FEDERAL RESERVE BOARD

In connection with the interest rate problem, the Chairman recommended that a person with small business experience be named to fill the next vacancy on the Federal Reserve Board.

The Chairman has been concerned about the Federal Reserve monetary policy, which has been extremely restrictive for most of 1981. He expressed the fear that the interest-sensitive sectors of the economy, including homebuilding, automobile dealers, and other small business firms, have been bearing too much of the brunt of the Fed's tight credit policy.

The Chairman's recommendation was reinforced in October, when the National Advisory Council to the Committee on Small Business unanimously passed a resolution urging the Committee to "take a leadership role in assuring that a small business person is appointed to the vacancy that will be created on the Board of Governors for the Federal Reserve System when Board Vice Chairman, Frederick H. Schultz's term expires on January 31, 1982."

On November 25, 1981, the Chairman introduced a sense of the Senate resolution advocating that a small business person be named to the Board. Subsequently, on December 8, a Republican alternative to a Robert C. Byrd amendment, offered by Senators Baker, Jepsen and Weicker, and expressing the sense of the Senate that a person with small business, agricultural or other small business experience should be named to the Federal Reserve Board, passed the Senate, by a vote of 90-0.

PROCUREMENT ASSISTANCE

Federal procurement policies are a major concern to the Small Business Committee. The Federal Government is the world's largest purchaser of goods and services; in 1980 alone, the Federal procurement budget exceeded $100 billion. Yet, all too often, small businesses miss out on opportunities to penetrate this vast Federal marketplace. Many small firms simply do not understand how to break through the maze of procurement rules and regulations. Other firms do not know how to market their products to Federal agencies, or simply avoid the Federal market due to the statutory and regulatory requirements related to Federal contracts.

The Committee on Small Business recognizes that it is in the national interest to encourage firms to contract with the Federal government. In fact, the Small Business Act of 1953 states that encouraging free competition and developing the capacity of small business is basic not only to the economic well-being of the country, but also to the security of this nation. Accordingly, this Committee is dedicated to simplifying government contracting procedures for small businesses. To date, Members of the Committee have taken several actions that would encourage small firms to do business with the Federal government.

DELINQUENT PAYMENTS

On May 6, 1981, Senators Weicker and Danforth co-introduced S. 1131, "The Delinquent Payments Act of 1981." This legislation would require the Federal government to pay interest on its overdue bills and prohibit Federal agencies from taking early payment discounts long after the discount period has ended.

The Small Business Committee learned first-hand about the Federal government's tendency to pay its bills late during its March 9, 1981, hearing on the Role of Small Business in the Nation's Economy. Witness Ron Chaney, the owner of a cleaning business in Connecticut, told the Committee that his firm had

been trying for five months to collect $10,000 for services delivered to the U.S. Navy. Mr. Chainey pointed out that many companies like his are forced to borrow money at outrageous interest rates to cover their obligations while they wait for the Federal government to pay its bills. He added that the $10,000 owed his firm was accumulating no interest, meeting no payroll, nor covering any of his other operating expenses. In fact, GAO studies show that nearly one-third of the government's bills are paid late.

On May 13, 1981, Chairman Weicker testified about the severe economic impact of late payments on the small business community during hearings held by the Governmental Affairs Subcommittee on Federal Expenditures, Research, and Rules to consider S. 1131. The Subcommittee also received testimony from several small business trade associations in support of the Delinquent Payments Act. On December 9, 1981, the Governmental Affairs Committee favorably reported out S. 1131, and on December 15, 1981, the bill passed the Senate.

GOVERNMENT COMPETITION WITH SMALL BUSINESS

The Subcommittee on Advocacy and the Future of Small Business, chaired by Senator S.I. Hayakawa, has taken an active role in examining the extent of government competition with the private sector. Many small business owners believe that the Federal government should rely on the private sector to supply its commercial goods and services. Further, they maintain that the government should not compete with the private sector by accomplishing these efforts with their own non-profit personnel and facilities. Several leading small business organizations and an SBA Advocacy Task Group on Government Competition have called on Congress to legislate in this important area.

On June 22, 1981, Senator Hayakawa introduced S.J. Res. 93, a resolution that reaffirms a long-standing executive policy (OMB Circular A-76) of reliance on the private sector for supply of the commercial and industrial goods and services needed by the Federal government. In his floor statement on S.J. Res. 93, Senator Hayakawa pointed out that his proposal does not reflect a shift in governmental policy; rather, it is a clarification of an existing policy that has been subject to varied interpretations and shifts in emphasis over the years.

To date, the Subcommittee on Advocacy and the Future of Small Business has held three hearings on the issue of government competition with small business. At its June 24, 1981, hearing, the Subcommittee heard from several small business owners about their personal experiences with Federal competition in their industries. The hearing also focused on the SBA Office of Advocacy Task Force report entitled Government Competition: A Threat to Small Businesses. The Subcommittee also received testimony about the extent of the competition problem from the GAO and the Office of Management and Budget.

On August 27, 1981, the Subcommittee held a field hearing in

Los Angeles, California and again heard from a number of small business persons who had had negative experiences with government competition. The most recent hearing was held by the Subcommittee on November 4, 1981. During the hearing, the Subcommittee received testimony from the Department of Defense, the General Services Administration, the General Accounting Office, and small business representatives. Senator Hayakawa also read a letter from David Stockman, the Director of the Office of Management and Budget, expressing the Administration's total support for S.J. Res. 93. The Resolution is currently pending in the Governmental Affairs Subcommittee on Federal Expenditures, Research, and Rules.

SMALL BUSINESS CONTRACT PAYMENT PROCEDURES ACT

On October 28, 1981, the Chairman introduced S. 1792, the Contract Payment Procedures Act of 1981. The bill would eliminate retainage for small business contracts in certain circumstances. Retainage is the practice of withholding a percentage of a construction contractor's progress payments pending satisfactory completion of all required contractual work. In his statement on the Senate floor, Weicker pointed out that the practice of retainage is costly -- small contractors must cover an average of $200,000 annually in outstanding retainages -- and duplicative of other standard contracting procedures.

FEDERAL PROCUREMENT SYSTEM

The Office of Federal Procurement Policy (OFPP) recently transmitted to Congress its proposal for reforming the nation's procurement systems. Because Congress is clearly on record in support of increased contract awards for small business concerns, the Senate Small Business Committee has a vital interest in the proposed Federal Procurement System. In fact, several so-called "socio-economic" procurement programs fall under the jurisdiction of the Small Business Committee, including Small Business Purchase Procedures which is one of the many areas targeted for revision by the OFPP. The Committee also is interested in those sections of the FPS proposal dealing with the government competition issues, late payments, and the Commerce Business Daily.

INNOVATION

On April 7, 1981, Senators Rudman and Weicker introduced S. 881, the Small Business Innovation Research Act.

Over the past decade the rate of productivity increase in the United States has been well below that of all leading industrial nations, most notably Japan and Germany. While this relative decline in American productivity stems from many factors, one of the chief causes has certainly been the slowdown in American innovation.

As other nations have been accelerating their research efforts, this country's Federal investment in research and development (R&D) in constant dollars, has remained virtually un-

changed for the past decade.

Numerous studies have shown that small businesses are the most efficient and fertile source of innovations. Yet only 3.5 to 4 percent of the Federal R&D budget is spent with small firms. This underutilization of small businesses in Federal R&D is especially regrettable when considering the highly successful track record of small firms in generating jobs, tax revenues, and other economic and societal benefits.

According to the Office of Federal Procurement Policy, between 1953 and 1973, firms with fewer than 1,000 employees accounted for approximately one-half of the major U.S. innovations. Similarly, a National Science Foundation study found that small firms produced about 24 times as many innovations per R&D dollar as large firms and four times as many as medium-sized firms.

Based on these studies, and on a series of Congressional hearings and executive agency studies during the past three years, the Committee concluded that the one way to revitalize the U.S. economy is to develop a means by which Federal agencies can better tap the innovative potential of small businesses.

The Small Business Innovation Research Act of 1981, S. 881, is designed to do just that. The purpose of the bill is twofold: to more effectively meet R&D needs brought on by the utilization of the small innovative firms (which have been consistently shown to be the most prolific source of new technologies); and, to attract private capital to commercialize the results of the Federal research.

Under the bill, each agency with an R&D budget in excess of $100 million will be required to establish a Small Business Innovation Research (SBIR) program modeled after that of the highly successful National Science Foundation program. Small firms will be invited to submit research proposals to an agency concerning topics selected by each agency in accordance with its own R&D objectives. Those proposals which show the most scientific and technical merit, and feasibility may be funded in the range of $30,000 to $50,000 for the initial development. Second-tier financing ranging from $100,000 to $500,000 may be provided for further research on those Phase I proposals that appear the most promising. Stringent peer review procedures are encouraged in the evaluation of all proposals.

In assessing Phase II proposals of approximately equal scientific and technical merit, agencies shall give special consideration to recipients of Phase I grants that have attracted private sector funding commitments to pursue commercial applications of the research. This special consideration serves as a built-in incentive for participants in the program to seek ways to build upon the Federal research, thus fulfilling one of the bill's primary objectives.

The Small Business Committee held five days of hearings in

1981, to consider S. 881. The first, on May 13 in Washington, elicited the views of past recipients of Research and Development awards from the National Science Foundation's SBIR program (the program after which S. 881 is modeled).

On June 30, the Committee traveled to Boston, where members of the academic community, as well as small business owners testified on the bill.

On July 15 and 16, the Committee heard the views of Federal agencies who would be affected by the legislation. Not surprisingly, the reaction was mixed, with several witnesses expressing reservations about the mandate of the bill. Senator Rudman, however, disagreed with claims that the legislation would threaten the quality of Federal R&D, and criticized the agencies' unwillingness to admit more small businesses into their R&D programs.

A field hearing on the bill, chaired by Senator Hayakawa, was held in Los Angeles on July 24.

On September 22, 1981, the Committee ordered an amended version of the bill favorably reported on a roll call vote of 16-0.

In a letter to Senator Rudman, President Reagan expressed his support for the legislation. "Your concerns that small firms be able to participate equitably in Federal Research and Development is shared by the Administration," the President wrote. "In the long run, all sectors of the economy are likely to benefit from the increased competition and research incentives your legislation would provide. I congratulate you on the leadership you have shown in advancing the interests of those small businesses which are the job-producing lifeblood of our economy."

On December 8, the Senate passed S. 881, by a vote of 90-0. It now awaits action by the House.

FINANCING SMALL BUSINESS IN URBAN AREAS

The Committee has paid special attention to the promotion of local economic development through small business incentives. It has become clear that the cultivation of a healthy small business community is central to neighborhood economic development and private sector job creation. In this vein, the Committee has looked at ways to foster small business, including tax and other targeted incentives.

The Committee has become deeply involved in the issue of tax-exempt Industrial Development Bonds (IDBs), principally because these are an important instrument of reasonable-cost financing for small and medium-sized businesses. In most cases, the tax-exempt status accorded small-issue IDBs is responsible for attracting small business participation in major economic development strategies.

The Chairman initiated the effort to suspend the implementation of IRS Ruling 81-216, which was promulgated on August 23, 1981, to prohibit the pooling of small-issue IDBs. Weicker argued that the ruling is punitive for small business and that it comes at the worst possible time -- with record-high interest rates and the curtailment of many federal aid programs for economic development. In that connection, he introduced S. 1635, which was referred to the Finance Committee.

A hearing on IDBs was conducted by the Subcommittee on Urban and Rural Economic Development on October 5, 1981. Chaired by Senator Alfonse D'Amato, the hearing produced testimony strongly in support of a continuation of the pooling of IDBs and a rejection of the IRS position.

Subsequently, Senator D'Amato, along with Senators Dole, Stevens, and Weicker, introduced an amendment to the Continuing Appropriations Resolution, which would prohibit IRS from enforcing Ruling 81-216 until March 31, 1982. The amendment passed, and was signed into law.

ENTERPRISE ZONES

The Committee also intends to initiate an examination of the concept of broad-scale tax abatement for businesses located in distressed area "enterprise zones." Location and expansion decisions are influenced by a host of important considerations, of which tax abatement is only one. To be sure, tax reduction may be a necessary consideration in investment decisions, particularly in some distressed areas, but it may not be a decisive factor.

The Chairman has decided to accord a top priority to examining the factors influencing small business expansion and location decisions in enterprise zones. Senator Weicker intends to study the factors in terms of their relative importance for small business investment and to be able to make recommendations as to the provision of appropriate incentives and the removal of any disincentives.

DETERIORATION OF THE DEFENSE INDUSTRIAL BASE

The Committee held a one day hearing on the subject of the U.S. defense industrial infrastructure, with particular concern about the small business, subcontractor component.

The main conclusion drawn from that hearing was that chiefly for four reasons, the subcontractor portion of the industrial base is its weakest point, and the Achilles heel of the current defense mobilization effort. Specifically, the evidence showed that the subcontractor base:

(1) Lacks productive capacity and is unable or unwilling to undertake major capacity expansion programs;

(2) Has little or no access to the financing necessary to

(3) Is characterized by a severe shortage of skilled workers, particularly trained machinists;

(4) Is unable to cope with the blizzard of regulatory and specification segments that accompany defense work.

Witnesses noted that a "dual economy" characterizes the U.S. defense production capacity, because the factors outlined above impact the major industrial "prime" contractors far less than the thousands of small, subcontractors in the base. Notwithstanding that fact however, deficiencies in the subcontractor base can limit the readiness and expansion capacity of the entire U.S. defense industry.

ANTITRUST/MERGER

On December 1, 1981, the Subcommittee on Productivity and Competition, chaired by Senator Gorton, began an exploration of Federal antitrust policy as it relates to small business. The Committee believes that one of the greatest threats to the health of the nation's small businesses, as well as to the overall strength of the economy, is the growing concentration of economic power in the hands of a few.

In his letter of invitation to hearing witnesses, Senator Gorton noted: "If the program for economic recovery is to work, it is absolutely imperative that the economy remain competitive. It is especially important that small business, the expansion of which is crucial to the recovery, not be hampered by illegal, non-competitive acts. The antitrust laws are the first line of defense against excessive economic concentration. In the interests of a free, competitive economy, I believe we must have vigorous enforcement of them."

During the December 1 hearing, Senator Gorton pointed out that during 1981, there have been an unusually high number of mergers between large firms. This is not a completely new phenomenon as mergers have historically come in waves. However, Committee members are concerned that the current merger wave is being stimulated at least in part by a perception in the private sector that the FTC and the Justice Department have shifted course and will not vigorously enforce the antitrust laws that relate to mergers and acquisitions.

This perception is extremely dangerous for many small businesses. The following statistics underscore the gravity of the situation. The top 100 Fortune firms control the same share of manufacturing assets that the top 200 did 30 years ago. This means that today, the same amount of the nation's capital assets are concentrated in half as many hands. The top 200 firms now control 61 percent of the nation's manufacturing and mining assets, which is the same percentage owned by the top 1000 enterprises at the start of World War II. Small and medium-sized businesses today control less than 27 percent of this country's corporate assets, whereas they owned nearly twice that percentage

as recently as 1960.

As industries and markets become more concentrated, the ability of small businesses to compete in those industries and markets is diminished. Committee members believe that this is detrimental to the economy as a whole because the benefits accruing from a healthy small business sector in terms of innovation and employment are decreased. Also, it is likely that under more concentrated conditions consumers will have to pay higher prices than they would under more competitive conditions.

In addition, the announced intentions not to enforce the law against resale price maintenance, which potentially affects thousands of small business men and women, as well as statements by persons in charge of enforcement, suggests that the Administration may, by selective enforcement, be rewriting the antitrust laws. Committee members noted that any approach which amounts to a change in existing law must be approved by Congress.

THE SMALL BUSINESS ADVISORY COUNCIL

On June 22, 1981, the Chairman and the Ranking Minority Member announced the formation of the National Advisory Council to the Committee on Small Business. The concept behind the Council was to provide Committee members with regular, grassroots input from small business men and women in the field. "These people, involved with a small business on a day-to-day basis, are in the best position to tell us what the problems of inflation, high interest rates and excessive regulation are doing to them and their businesses," Weicker explained in announcing the Council.

The Council is made up of 25 small business owners from around the country, chosen by the Members of the Committee. Committee members will meet with the Council at least twice a year and will maintain regular contact with them.

At the first meeting of the Council on October 28, 1981, the group elected Connecticut entrepreneur Shaw Mudge as their Chairman. The Council also unanimously passed a resolution calling on the Committee to take a leadership role in assuring that a small business owner or someone with considerable small business background is appointed to fill the Federal Reserve Board vacancy that will be created when the term of Vice Chairman Frederick Schultz' term expires on January 31, 1982.

The Committee is grateful to the assistance and the insights provided by the Advisory Council, and believes they will make an important contribution to the work of the Committee in the months to come.

Council members are:

Mr. Hugh Allred
Warehouse Discount Groceries Corporation
Cullman, Alabama

Mr. James Beavers
Hensley Auto Parts
Clinton, Arkansas

Mr. Leon P. Brassard
Heat, Inc.
Hudson, New Hampshire

Mr. David Bruce
Bruce-Anderson, Inc.
Bozeman, Montana

Ms. Mary Diener
Diener and Associates, Inc.
Research Triangle Park, North Carolina

Mr. William Farden
Outdoor Empire Publishing Company
Seattle, Washington

Mr. Walter Floss, Jr.
Floss Insurance Agency
East Amherst, New York

Mr. Leonard Forsgren
Corroon and Black of Oregon
Portland, Oregon

Mr. Bruce Hopewell
Lincoln Plaza Associates, Inc.
New York, New York

Mr. Oscar Hornsby
Oscar Hornsby, Inc.
Somerset, Kentucky

Mr. Michael Lefkiades
Michigan Coni Islands, Inc.
Bay City, Michigan

Ms. Helen K. Leslie
K & W Supply House
St. Petersburg, Florida

Mr. Bill Lyttle
Waterbury Pen Company
Bridgeport, Connecticut

Mr. Forrest H. Mertz
Mertz, Inc.
Ponca City, Oklahoma

Ms. Thelma Moss
AA Glassmobile
Dorchester, Massachusetts

Mr. Shaw Mudge, Chairman
Shaw Mudge and Company
Stamford, Connecticut

Mr. Therman McKenzie
M & M Products, Inc.
Forest Park, Georgia

Mr. Bill Nourse
Brookmade Hardware & Supply
Nashville, Tennessee

Dr. Arthur S. Obermayer
Moleculon Research Corporation
Cambridge, Massachusetts

Mr. Francis Ravel
Olympic Sales Company, Inc.
Los Angeles, California

Mr. James B. Rhoads
Hyatt & Rhoads
Atlanta, Georgia

Mr. Ralph H. Steinbarth
La Preferida, Inc.
Chicago, Illinois

Mr. Glen Stout
The Maxi-Switch Co.
Minneapolis, Minnesota

Mr. David Tomlinson
AMWEST
Salt Lake City, Utah

Mr. Morris F. Womack
All Seals, Inc.
Friendswood, Texas

STATUS OF KEY SMALL BUSINESS LEGISLATION

Following is a summary of the major pieces of small business legislation introduced by Committee members and the status of the various bills:

S. 360 — The Omnibus Small Business Capital Formation Act of 1981, introduced by Senators Weicker, Nunn and others. Referred to the Committee on Finance.

S. 360 sought to make major changes in the nation's tax laws as they affect small business. Broken down into five general areas, the bill was an attempt to correct existing inequities that make obtaining and retaining capital almost impossible for small business. S. 360 proposed a number of measures, including significant new tax credits, rollovers, corporate rate reduction, accelerated and simplified depreciation, and reforms in inventory accounting procedures and estate gift tax laws.

S. 360 was not reported out of the Finance Committee. However, a number of its provisions, including accelerated depreciation and estate and gift tax reform, were included by the Finance Committee in the Economic Recovery Tax Act. Additionally, a Weicker-Nunn amendment to the Economic Recovery Tax Act, providing corporate rate reduction, passed the Senate by a vote of 92-0.

S. 580 — The Pollution Control Bond Program Act, introduced by Senators Levin, Hayakawa and others. Referred to the Small Business Committee.

This bill would establish program levels for the Small Business Administration's Pollution Control Bond Program.

S. 580 was favorably reported by the Small Business Committee and the Budget Committee, and was included in the small business conference agreement that became Title XIX.

S. 881 — The Small Business Innovation Research Act, introduced by Senators Rudman and Weicker. Referred to the Small Business Committee.

The bill would require Federal agencies with research and development budgets of more than $100 million to earmark a percentage of that money for use by small firms. The legislation seeks to direct more Federal R&D money to small business, while at the same time achieving more of the Federal Government's R&D goals by using the most efficient and effective source of innovation available -- small business.

S. 881, with 86 cosponsors, was reported out of Committee on September 22, 1981, and passed the Senate on December 8, by a vote of 92-0.

S. 987 — An Amendment to the Small Business Act, introduced by Senators Nunn, Huddleston, Bumpers, Baucus, Levin and Dixon. Referred to the Small Business Committee.

S. 987 would amend the Small Business Administration disaster regulations to allow applications for assistance stemming from disasters on or before March 19, 1981, to be acted upon by the SBA under the regulations in effect on the date the disaster commenced.

S. 987 was not reported out of Committee. However, a similar measure, S. 865, introduced by Senators Pryor and Bumpers, was favorably reported by the Committee, and included in the small business conference agreement that became Title XIX.

S. 1131 — The Delinquent Payments Act, introduced by Senators Weicker and Danforth. Referred to Governmental Affairs Subcommittee on Federal Expenditures, Research, and Rules.

This bill seeks to address the problem of slow payment by the Federal Government to private contractors by setting a 30-day limit on payment of bills. After 30 days, any Government agency which has not paid a bill will be charged standard interest on the delinquent amount. That money will come out of the Agency's existing operating budget.
S. 1131 was reported out of the Governmental Affairs Committee on December 9, 1981, and passed by the Senate on December 15, 1981.

S. 1440 — The Small Business Tax Credit Act, introduced by Senator Weicker, referred to Committee on Finance.

This bill is designed to reduce unemployment by providing tax credits to small business employers who hire the at-risk unemployed and train them for productive jobs in the private sector.

S. 1440 is pending in the Finance Committee.

S. 1620 — Amendment to the Small Business Act, introduced by Senator Weicker. Referred to the Small Business Committee.

S. 1620 would amend the Small Business Act by extending the 8(a) Pilot Procurement Program until March 31, 1983, and placing the program with a Federal agency other than the Department of Defense.

S. 1620 was reported out of the Small Business Committee on September 22, 1981. Action by the full Senate is expected early in 1982.

S.J. Res. 93 Introduced by Senator Hayakawa. Referred to the Governmental Affairs Committee.

This Resolution would reaffirm the commitment of the Federal Government to rely, where possible and economically favorable, on the goods and services of private enterprise for government purchasing.

Three hearings have now been held in the Small Business Committee. S.J. Res. 93 now awaits further action in the Governmental Affairs Committee.

S. 1782 The Small Business Contract Payment Procedures Act. Introduced by Senator Weicker. Referred to Governmental Affairs Committee.

This bill would eliminate retainage for small business construction contractors under certain circumstances. Retainage is the practice of withholding a percentage of a contractor's progress payments pending satisfactory completion of work. Under this bill, Federal contract officers would have the authority to waive retainage in situations where the work is being completed satisfactorily and on schedule, thus freeing up the money for use by the contractor and eliminating cash flow problems.

S. 1782 is pending in the Governmental Affairs Committee.

S. 1797 The Private Sector Opportunities Act. Introduced by Senators Dole and Weicker. Referred to the Labor and Human Resources Committee.

This bill would provide private sector training and placement opportunities for residents of enterprise zones, emphasizing the use of community based organizations and the involvement of small business concerns.

S. 1797 is pending in the Labor and Human Resources Committee.